

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Cecelia San Pedro on April 25, 2006

DATED: June 1, 2006

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On April 25, 2006, Carolyn Miller, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, and Troy Dahlberg of the Audit Committee, interviewed Cecelia San Pedro. Ms. San Pedro was represented during this interview by her lawyer, Jason Lee of Shartsis Friese LLP. Also present were Rahul Khona and Samer Rezkalia of KPMG, and Ray Sarola of Willkie. This interview took place in a conference room on the 3rd floor of the City Administration Building in San Diego and lasted approximately four and one-half hours.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Ms. San Pedro, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

#### *Warnings*

Mr. Dahlberg explained that the interview was on behalf of the Audit Committee and that no privilege applied to the interview as between the Audit Committee and the witness. He informed Ms. San Pedro that information she communicates during the interview may be made public or otherwise turned over to the government, after which it seems likely that any privilege attaching to the interview memoranda will be lost. He asked that Ms. San Pedro keep the interview confidential to assist the Audit Committee's process of gathering information. Ms. San Pedro was instructed that if the questions asked are not producing clear answers to take her time and explain herself. Ms. Miller informed her that breaks could be taken whenever she needed them.

Mr. Lee asked whether he would have an opportunity to review or correct any notes or memos concerning this interview. Mr. Dahlberg responded that Vinson & Elkins was criticized for allowing witnesses to review their notes, and this opportunity would not be afforded by the Audit Committee. He stated that the witness was encouraged to correct any misunderstandings during the dialogue of the interview.

#### *Background*

Mr. Dahlberg informed Ms. San Pedro that he had read the memos of her prior interviews as background and asked her to walk through her employment history. Ms. San Pedro started working for the City in 1991 with the Auditor's Department, where she worked with

accounting for the general fund. Around 1999, she moved to the "retirement fund desk," where she worked on pension accounting. She held this position until 2003, when she switched to grant accounting and preparation of the long-term debt footnote for the 2005 City CAFR.

Ms. San Pedro has a Bachelor's degree and a Master's degree in Accounting from San Diego State University. She received her CPA license before getting her Master's degree, which was in 1996 or 1997. Mr. Dahlberg asked if she needed to complete 500 audit hours for her CPA license, and she responded that she had completed this requirement working for Calderon Jaham & Osborn (CJO), both in their office and at their clients' locations. She was contracted out by the City to CJO for 4 months straight and worked on financial audits for their clients.

Ms. Miller asked if she received any pension training with the City. Ms. San Pedro stated that she had not, though she had attended Government Finance Officers Association (GFOA) conferences when they were held in San Diego. She noted that the City tried to minimize travel costs, especially in her department, and that it was cheaper for the City to train its employees when conferences came to town. Most of the conferences that came to San Diego, however, were for non-governmental accounting. Ms. San Pedro did not request to participate in out-of-town training because she has a family, was busy at work, and was not fond of traveling. Ms. Miller asked whether she had received in-house training during the time that she worked on retirement issues. She responded that the City's contract with CJO required them to provide annual accounting training, which took place over two days. This training was not necessarily pension-related, instead covering broad GASB and FASB issues. Ms. San Pedro noted that pension-related training would have only benefited her, and not other City employees.

#### *Procedures in the City Auditor & Comptroller's Office*

During the time she worked on retirement issues, Ms. San Pedro's responsibilities included maintaining the SDCERS fund and generating a financial statement at the end of the year for inclusion in the City's CAFR. One unique aspect of working on the SDCERS fund was that monthly reports were also necessary to provide to the Board at its monthly meetings. The preparation of the monthly reports mimicked the year-end process with information cumulative to that month, and Ms. San Pedro generated fund balance statements, statements of earnings, and income statements for SDCERS. Ms. Miller asked how information from SDCERS and other departments was entered into the computer system used for generating these reports. Ms. San Pedro replied that the data comprised "mini-systems," such as payroll, and the retirement fund received bi-weekly contributions from various sources which were all recorded in the "general ledger system." She looked at the numbers in the general ledger system and approved any administrative expenditures, such as payments to vendors. Mr. Dahlberg stated that he believed SDCERS was treated like every other fund, except for its investments. Ms. San Pedro agreed, noting that SDCERS investment data did not automatically feed into the general ledger. This information was manually entered into the general ledger by Ms. San Pedro. Other, non-investment information was part of the general ledger system and entered automatically like other fund data.

While she worked on accounting for the retirement fund, Rudy Graciano, the Principal Accountant for the Operations Section, was her direct supervisor. Ms. San Pedro was the "lead accountant" in the Accounting Section and there were five or six staff accountants

beneath her. Mr. Graciano reported to Phil Phillips, who was the Accounting Division Manager. The level above him was the Assistant Auditor, who was Terri Webster, and Ed Ryan was the Comptroller. Ms. Miller asked if she always reported issues to Mr. Graciano, and she responded that she worked with Ms. Webster on retirement issues at the same time that she worked for Mr. Graciano. Ms. San Pedro stated that usually Ms. Webster approached her with issues for her to look into. When she had a retirement question, she turned to Ms. Webster because Ms. Webster was more knowledgeable in that area, while Mr. Graciano knew more about accounting or GAAP issues. If a retirement question was related to the financial statements, she would have asked Mr. Graciano for the correct process, or informed him of the action she would take. Ms. Miller asked whether she ever worked directly for, or had contact with, Ed Ryan; she replied that she had not. This was the structure in the Auditor's Office when Ms. San Pedro began working on the retirement fund and it did not change during her tenure. Phil Phillips was still working in this role at the time Ms. San Pedro left retirement accounting. Mr. Dahlberg asked whether Ms. San Pedro was a principal accountant at the time of the interview and she responded that she had not been then, and was not at the time of the interview, a Principal Accountant.

Mr. Dahlberg asked if Ed Wochaski (Principal Accountant, Auditor's Office) also reported to Mr. Graciano, and Ms. San Pedro replied that they were on the same level so Mr. Wochaski probably reported to Mr. Phillips. Ms. San Pedro stated that Mr. Wochaski would also have had his own staff. Mr. Dahlberg then asked if she had any involvement with Mr. Wochaski or with water issues. Ms. San Pedro replied that when Mr. Wochaski's staff was working on their footnote, they would ask her for the information she provided for the City's CAFR to ensure that it matched the information on the water fund's stand-alone CAFR.

Ms. Miller asked whether she was familiar with Mike Phillips. Ms. San Pedro stated that he was a former accountant for the retirement fund. After he left this position, Joan Talbert took over for a year or two before Ms. San Pedro assumed this position. Ms. San Pedro did not talk to him about her job, but she reported to him when she first started working for the City and he would help her with requests from vendors for payment. Ms. Miller then asked about Darlene Morrow-Truver (Financial Operations Manager, Auditor's Office), but Ms. San Pedro could not remember her involvement with retirement accounting. She only remembered that when Ms. Morrow-Truver came back as Audit Division Manager, and the department began getting questions about the CAFR, Ms. Morrow-Truver started to learn and work with pension issues, such as the footnote preparation. This was in late 2003, and Ms. San Pedro did not remember any involvement she had with pension issues before this time.

Ms. Miller asked whether Ms. San Pedro's department had regular meetings, and Ms. San Pedro replied that they had quarterly recognition meetings to give employees awards, but she did not otherwise meet regularly with Mr. Graciano's group. She would only meet with them if an issue they discussed involved her, such as the year-end preparation of financial statements. She recalled attending a few meetings with CJO, but she was not among the accounting staff that met with the outside auditors on a weekly basis. After she submitted the pension numbers for the financials, she did not have further involvement with the outside auditors. Mr. Dahlberg asked who would have been the contact person for the outside auditors if they had questions regarding the SDCERS CAFR. Ms. San Pedro said that they might have asked Dawne Clark or Terri Webster, but she did not know for sure.

Mr. Dahlberg asked if Ms. San Pedro had been involved, outside of her work with the City and pension CAFRs, with any Preliminary Offering Statements (POS). Ms. San Pedro noted that before she worked for the retirement fund, she prepared schedules for Tax Anticipation Notes (TAN) that were included in the TAN POS. She stated that there were times when information was requested from her and she did not know for what purpose it was ultimately used, but she was not aware of any involvement she might have had with any POS documents.

### ***SDCERS CAFR***

Mr. Dahlberg asked Ms. San Pedro if the pension fund had its own CAFR. Ms. San Pedro noted that unlike other funds, whose annual statements were called "stand-alone financial statements," the pension system had a SDCERS CAFR. She speculated that the reason for this might be that the pension system had its own set of GASB rules. According to Ms. San Pedro, this document was "almost solely prepared by investment staff at SDCERS." Ms. San Pedro stated that she gave her financial information to the investment staff at SDCERS and they drafted the notes to the SDCERS CAFR. The investment staff occasionally asked her for certain information, but they were the ones who drafted the footnotes to this document. She was not aware of the involvement of outside auditors in this process.

Dawne Clark (SDCERS Assistant Investment Officer) was responsible for the preparation of the SDCERS CAFR, and when this document was completed, it was sent to Ms. San Pedro and Terri Webster (Deputy City Auditor) to review. Ms. Miller asked her what procedure she used to review this document, and Ms. San Pedro stated that she would only review the data in the financial statements that she provided to SDCERS. She was not sure whether this was the process used by Terri Webster. Ms. San Pedro did not speak to Ms. Webster about the review of this document, and did not make changes to it other than to enter her numbers. Ms. Miller asked her if she ever read the text of the SDCERS CAFR and Ms. San Pedro replied that she had read the footnotes, but did not recall seeing anything that should have been changed, or making any changes herself.

Mr. Dahlberg asked if Ms. San Pedro was a City accountant and SDCERS accountant at the same time, and she responded that she was. He asked who Lawrence Grissom (SDCERS Administrator) would go to if he had accounting questions and Ms. San Pedro replied that he would probably turn to Ms. Webster since she was on the SDCERS Board. If the issue related to a particular number, Ms. Webster would ask Ms. San Pedro. This would be the typical way questions from SDCERS would be dealt with; Ms. San Pedro did not recall being contacted directly by Lorainne Chapin (SDCERS General Counsel) or SDCERS Board members.

Ms. San Pedro had contact with the investment staff at SDCERS on a monthly basis to reconcile investment numbers between SDCERS and the City. Her primary contacts were Dawne Clark and Robin Alexo (phonetic). Ms. San Pedro would ensure that the City's numbers reconciled with theirs, and it would be their responsibility to reconcile with SDCERS's bank (State Street). Mr. Dahlberg asked if there was any other interaction that she had with SDCERS, and she replied that she had meetings with Patrick Lane (SDCERS CFO) and Paul Barnett (Assistant SDCERS Administrator) when the issue dealt with the general ledger. Because Ms. San Pedro approved travel expenses, she would talk to Ms. Chapin or the individual employee who generated the travel expense about those issues. Mr. Dahlberg asked whether she

would ask Ms. Chapin if she had a question about booking a liability and she said that she would ask Ms. Webster instead.

### ***Pension Footnote in the City's CAFR***

Ms. San Pedro stated that the pension footnote was located in the City's CAFR, and her role was to feed numbers into a footnote template. Karen Frank was the accountant under Mr. Graciano who coordinated the preparation of the CAFR. Mr. Dahlberg asked Ms. San Pedro if she reviewed the pension footnote or any other part of the CAFR once it was completed, and Ms. San Pedro replied "hardly, I don't recall." She was aware that Mr. Graciano reviewed the entire CAFR, and believed that he worked with the outside auditors when drafting the footnote. Ms. Miller asked if Mr. Graciano had ever come to Ms. San Pedro with a question about the pension footnote, and she recalled one instance where he asked her to check the accuracy of a statement with the actuary and it was later dropped from the footnote. Other than that instance, Ms. San Pedro only recalled entering numbers into the template she received from Ms. Frank. She believed that the template was created by the City by copying the prior year's statement, saving it as this year's statement, blanking out the numbers, then distributing it to enter new information.

Ms. Miller asked if Ms. San Pedro ever suggested changes to the language of the footnote when it was distributed to her. Ms. San Pedro responded that she did not read the text or suggest changes, and did not know of anyone else in her department who read the text other than Mr. Graciano. She did not recall being instructed to review the footnote language. Mr. Dahlberg asked whether Mr. Ryan or Ms. Webster reviewed the financial information in the pension and City CAFRs before they were released. Ms. San Pedro replied that she did not know what they read, only that they received drafts, and that she recalled seeing the pension CAFR on Ms. Webster's desk with markings on it. She had never received any questions from either of them concerning the drafts that were circulated.

She did not know the manner in which Mr. Ryan reviewed the CAFR since he was on a different floor. She did remember an instance where he asked her directly to look into recording a health care liability, specifically whether the City had a responsibility to show a liability for health care benefits in SDCERS financial statements. She looked into the issue and did not find anything, though she later learned that there was a GASB provision that was proposed to address this issue. She received this proposal from either Mr. Ryan or Ms. Webster and called GFOA to inquire about its status; they told her that it was not yet an official GASB pronouncement.

Mr. Dahlberg noted that the statement in the pension footnote to the City's CAFR used in the Ballpark Offering that the City made contributions based on actuarially determined rates indicated to him that the employer's rates were actuarially calculated. He then asked Ms. San Pedro if she read that language differently. She responded that she did not know if "determined" could mean something different than "calculated," and noted that her calculations started from the actuarially determined rates. Mr. Dahlberg asked if the meaning of this language ever came up in discussions, and she responded that it did not. Mr. Dahlberg asked if she ever wondered about the meaning of this language herself. She replied that she did not wonder about this, and stated that a "normal person" probably would not know how the rates are calculated.

Mr. Dahlberg asked if she was aware of situations where the SDCERS Board or Mr. Grissom, after reviewing the CAFR, would come back to the Accounting Department to question the financials or the notes. Ms. San Pedro responded that she did not know what goes on in SDCERS board meetings, and if this occurred, Ms. San Pedro would have been asked by Ms. Webster to look into the issue. She stated that she did not get involved with SDCERS decision-making after she gave them the information they required.

### ***Contact with City Officials***

Regarding her contacts with other City employees, Ms. San Pedro stated that she did not interact with the City Manager, elected officials, or the City Attorney prior to June of 2003. Mr. Dahlberg then asked whether she had a role in preparing information for presentations to rating agencies. She replied that she received requests from Lakshmi Kommi (Financing Services Manager) for certain data, and assumed it would have gone to rating agencies because Ms. Kommi dealt with them, but she was not sure since she was not part of this group.

### ***Contact with CJO***

Larry Green was her contact person at CJO. He was a contract employee for them, and was in charge of auditing SDCERS. He would ask her specific questions on dollar amounts or how various reserves function. Ms. Miller asked if he would review her work on the pension footnote in the City CAFR, and Ms. San Pedro replied that she would not have given the City CAFR to him, and did not remember him otherwise reviewing it. If he had questions about "subsequent events" or fund planning issues, he would have gone to Tom Saiz, the CJO partner in charge of the City. Mr. Dahlberg asked how CJO would receive their information necessary to conduct the audit. Ms. San Pedro thought that Mr. Graciano would have provided this information, but she was unaware of this process.

### ***City's Contribution Rates - MP-1***

Ms. Miller asked if she was involved with checking the City's employer contribution rates, and Ms. San Pedro replied that she was. She would receive the actuary reports when they were released and convert that information into the City's contribution rates using a spreadsheet that was explained to her by Joan Talbert, her predecessor. Ms. San Pedro noted that "as part of MP-1 our rates are a lot lower than the actuary's calculated rates." Ms. Miller asked her to explain how the City paid less than the actuarially required rate, and she replied that she didn't have a good understanding of these concepts at the time. She did not know what information the actuary used in creating his recommended rates, or exactly how MP-1 affected this calculation. Other than the spreadsheet she used to calculate the City's rate, she did not receive any instruction on how MP-1 modified the City's contributions. She noted that Mr. Grissom always signed off on the rates she sent him.

Once calculated, the City's contribution rates would be provided to the retirement administrator for his signature, then sent back for Ms. San Pedro's signature before ultimately being sent to Payroll. Ms. Miller asked if she discussed these calculations with anyone before sending them to Mr. Grissom. She did not recall if she discussed these numbers with Mr. Graciano, but stated that if the work were new to her, she would have sat down with him to keep him informed of her work.

Regarding the SDCERS funded ratio, Ms. San Pedro stated that she took this number from the actuary's report for inclusion in the City's CAFR, but did not understand its significance. Ms. Miller asked if it was correct that it would not have mattered to her whether the ratio was at 95% or 65%, and Ms. San Pedro said that was correct. She did not monitor the funding ratio, and was not asked by anyone to do so. She noted that SDCERS received this number before it was sent to her office.

Mr. Rezkalia asked if the fact that the City paid less than the actuarially required amount under MP-1 caused her any concern, and she replied that it did not. Ms. San Pedro felt the agreement was a procedure that was accepted. She did not read MP-1, and did not ask anyone about it. Mr. Rezkalia asked whether any falling numbers would have caused her concern, and she responded that these numbers did not concern her because she did not understand their significance.

### ***City's Contribution Rates - MP-2***

Ms. Miller asked if Ms. San Pedro worked at the retirement desk during MP-2, and she replied that she did. She recalled discussions about the impact of MP-2, and stated that Ms. Webster would help her calculate the City's rate under MP-2 because she was more knowledgeable about that agreement. Ms. San Pedro did not recall exactly how she calculated the rate under MP-2, but remembered that it was entirely different from the method under MP-1, and resulted in much higher contribution amounts. Ms. San Pedro was not aware, either as a citizen or City employee, why MP-2 was entered into.

### ***Blue Ribbon Committee***

Ms. Miller asked Ms. San Pedro if she was familiar with the Blue Ribbon Committee ("BRC"). Ms. San Pedro recalled the BRC, though she did not recall having any interaction with this group. She believed that if they needed information, they would have requested it from Ms. Webster. Ms. Webster might then have asked her for certain numbers, but she would not have known that they were intended for the BRC. Mr. Dahlberg asked whether she recalled receiving requests for information regarding investment returns on pension funds in Summer and Fall 2001, and she replied that she did not remember any such requests. She noted that she was on maternity leave from January to July 2001.

Ms. San Pedro recalled that the BRC issued a report, but did not recall when. She also did not recall whether her department instituted changes or held discussions as a result of the recommendations made in the BRC report. She did not read the report, and although she knew it contained recommendations for changes, she was not alarmed. Mr. Dahlberg asked when she became aware that decreased earnings would have an impact on pension funding, and she replied that she became aware after the investigations started and she learned more about these issues. Mr. Dahlberg asked specifically about her interaction with Mr. Roeder concerning investment earnings, and she replied that through discussions with him she was aware that earnings had dropped, but at the time of these discussions she did not know the significance of these figures.

### ***SDCERS Investment Earnings***

Ms. San Pedro was shown an email from Ms. Webster dated October 9, 2001, titled "EEEEK," regarding the drop in SDCERS investment returns (Exhibit 1). Ms. Miller asked if she recognized this document. Ms. San Pedro did not remember this email, but recalled that Ms. Webster would ask her for historical numbers, such as contribution amounts and undistributed earnings. Mr. Dahlberg asked if it was fair to observe that Ms. San Pedro communicated earnings information to Ms. Webster, and she stated that it was. She provided Ms. Webster information from which undistributed earnings could be calculated, but did not remember whether she pointed out this particular number. Mr. Dahlberg asked if she would typically point out such numbers and she responded that she would not. She did not recall whether she provided the 71% number referenced in the email to Ms. Webster, though she did not often run this number as a percentage. Usually, Ms. San Pedro just left a copy of the monthly SDCERS financial statements in Ms. Webster's inbox; she did not regularly brief Ms. Webster about this subject matter. Ms. San Pedro believed that earnings were "all subject to the economy," and did not recall thinking this was a big drop. She also did not recall whether there had been similar earnings drops prior to this email.

Mr. Dahlberg asked whether Ms. San Pedro was more aware of investment earnings after this email was sent. She responded that she did not recall being more aware and did not know if others were, apart from common knowledge of the economy slowing down. Mr. Dahlberg asked whether she contacted the SDCERS investment accountant to check the accuracy of these numbers, and she replied that she did not. She reconciled her numbers with the numbers from SDCERS, and if they reconciled there would not be any doubt about their accuracy. Mr. Dahlberg then asked whether she discussed this topic with Ed Ryan. Ms. San Pedro replied that Ms. Webster would invite her to meetings with Mr. Ryan if those meetings related to her work, but she did not recall specifically whether she discussed this issue with Mr. Ryan. Aside from the normal preparation of monthly financial statements, Ms. San Pedro did not recall any increased interest in investment earnings after this email was sent in October 2001.

### ***Surplus Earnings & the Waterfall***

Ms. San Pedro recalled meeting with Mr. Ryan concerning the City's inability to make waterfall distributions. She stated that she would typically be involved in meetings on this topic, along with Ms. Webster, Mr. Grissom, and Patrick Lane. Ms. Miller asked her who was responsible for determining how the waterfall functioned, and she replied that the waterfall was controlled by the Municipal Code. Ms. San Pedro explained that waterfall distributions were determined from numbers that were fed into the system by Mr. Grissom, Payroll, herself and others.

Ms. San Pedro was shown an email she sent to Mr. Graciano and others on October 9, 2001, regarding surplus undistributed earnings (Exhibit 2). Asked specifically about the "schedule of undistributed earnings" mentioned in the email, Ms. San Pedro stated that this schedule was separate from the CAFR she prepared which required the outside auditor's approval. She created this schedule starting with undistributed earnings, going through the waterfall, and eventually ending with surplus undistributed earnings. She calculated some of the information she needed to create this schedule herself, and received other information from Mr. Grissom and Payroll.



She was next shown an email from Mr. Grissom to Ms. Webster dated October 9, 2001, which referenced research done by Ms. San Pedro regarding earnings (Exhibit 3). Ms. Miller asked her about this research and Ms. San Pedro explained that the SDCERS Board was empowered by the waterfall to create various reserves. In the past, there was a "general reserve" that was funded with a dollar amount. Ms. San Pedro recalled trying to learn about this reserve and asking whether the City needed to increase this reserve around the time of this email. Ms. Miller asked about the reference in the email to "pressure" from "interest groups," and Ms. San Pedro replied that she did not know what this referred to and did not remember any discussions about this topic. Mr. Dahlberg asked about the reference to "worst case scenarios," and Ms. San Pedro responded that she would probably have been responsible for these projections, and that the City's main concern was whether the 13th Check could be paid that year. She did not recall being asked to run projections concerning the results of poor investment returns.

### *City's Net Pension Obligation*

Ms. San Pedro was shown a letter from Mr. Roeder to Mr. Grissom, dated May 15, 2001, transmitting information concerning the funding status of SDCERS (Exhibit 4). Mr. Dahlberg asked her why she received this letter and what information contained in this letter was relevant for her purposes. She stated that the table for the City's Net Pension Obligation ("NPO") was relevant because she inserted this information into the City CAFR footnotes. She did not recall providing information for the creation of the SDCERS CAFR or offering documents for bond issuances. Ms. Miller asked if she ever confirmed the accuracy of the information contained in this letter with the actuary, and she replied that she did not.

Mr. Dahlberg asked Ms. San Pedro who was responsible for booking the City's NPO. She responded that she was the person responsible, and she booked this amount annually at year end. She explained that the NPO existed because the City was not paying actuarially recommended rates as a result of MP-1. She did not know how this amount was calculated, but believed that under MP-1 the City was eventually expected to contribute an amount greater than the actuarially recommended rates to get the NPO back to zero. Mr. Dahlberg asked if she was aware of a reserve to offset the NPO so that it did not need to be booked. She replied that there was a reserve in SDCERS to cover the NPO, but the City expensed the NPO as a liability. Ms. San Pedro stated that she asked Ms. Webster why there was a reserve if the City expenses the NPO, and that reserve was eventually closed later in fiscal year 2003. Prior to this point, Ms. San Pedro was aware of the NPO reserve, but did not know its significance. She always booked the NPO liability on the City's books and always relied on the actuarial calculation for this number.

Ms. San Pedro was next shown an email from Ms. Webster dated November 19, 2003, regarding the NPO calculation (Exhibit 5). Ms. Miller asked whether Ms. San Pedro or Ms. Webster ever questioned how the NPO was being calculated, and Ms. San Pedro replied that she did not recall any such questioning. Ms. San Pedro identified "Dawne" in the email as Dawne Clark, the SDCERS Assistant Investment Officer who was responsible for the SDCERS CAFR. Ms. San Pedro did not know what was meant by the references in the email to calculating the NPO "without interest," or the CAFR being "outdated." She did not know whether she did any research on the NPO after this email was sent.

Mr. Dahlberg asked whether she ever discussed which liabilities went into the Actuarially Required Contribution ("ARC") and Ms. San Pedro stated that she did not recall any such discussions. If she became aware that the City had an unbooked liability, she would have contacted Mr. Graciano or Ms. Webster.

### *Corbett*

Ms. San Pedro recalled being asked to look into the *Corbett* payments to determine if the City needed to book this as a liability. After researching GASB, she determined that the City did not have to book this amount on its financial statements.

Ms. San Pedro was shown an email she sent to Patrick Lane dated August 23, 2002, regarding the *Corbett* liability (Exhibit 6). Mr. Dahlberg asked how she first found out about the *Corbett* lawsuit, and Ms. San Pedro responded that she believed she heard about it from Patrick Lane, but was not certain. She knew about this lawsuit before it was settled, and recalled meeting after the settlement with managers in her department to discuss the implementation of the increased benefits. As a result, she was aware that the Corbett settlement paid a benefit when the 13<sup>th</sup> Check was paid and accrued in other years, but she did not know how these amounts were calculated. From research she did into relevant GASB rules, Ms. San Pedro determined that the payment of this benefit did not need to be booked in the City's financial statements.

Mr. Dahlberg asked Ms. San Pedro who was responsible for being aware of liabilities that did not have operational amounts associated with them, but needed to be disclosed in the CAFR. She responded that she did not know who was responsible for this type of disclosure, and that her own involvement was only with the settlement's effect on the financial statements.

Ms. San Pedro vaguely remembered talking to someone from the City Attorney's Office about a lawsuit, but did not recall the lawsuit to which this conversation related. Mr. Dahlberg asked specifically whether these discussions involved whether Corbett payments were really "contingent," but Ms. San Pedro did not recall. She did not recall whether she was involved in any meetings regarding the contingent nature of Corbett payments, and noted that she did not have direct contact with this lawsuit, only its impact on the general ledger. Mr. Rezkalia asked whether anyone asked her not to book these payments and she replied that no one made this request.

### *Gleason*

Mr. Dahlberg asked Ms. San Pedro if she was still working with the pension fund at the time the *Gleason* lawsuit was filed, and she replied that she was. Mr. Dahlberg then asked if she was aware of the liability that this lawsuit posed to the pension system, and she replied that she only understood "liability" as it related to financial statements. She eventually came to learn that people discuss potential future payments as "liabilities" as well. Mr. Dahlberg asked if she would typically conduct an analysis of whether a liability should be booked internally before approaching outside auditors. Ms. San Pedro stated that she would have brought the issue to Mr. Graciano's attention because she did not work with that part of the footnote. She assumed that he would have discussed the issue with outside auditors.

Mr. Rezkalia asked who at the City sent ledgers to the outside auditors about pending litigations. Ms. San Pedro mentioned that Karen Frank might have done this, but did not know who would have initiated this process. Ms. Miller asked whether the City Attorney's Office would have been involved, and Ms. San Pedro replied that she did not know. Ms. Miller then asked if Ms. San Pedro recalled reading any affidavits associated with these lawsuits and she recalled writing an affidavit for the Gleason suit with the assistance of an outside consultant concerning the contributions that the SDCERS funds received, but did not recall working with the City Attorney's Office on this document.

### ***Pension Footnote: Corridor Funding***

Ms. San Pedro was shown an email she wrote on September 18, 2003 to Jeanne Cole recalling the events surrounding the review of the pension footnote by Mr. Roeder (Exhibit 7). Mr. Dahlberg asked her to explain how the review of the pension footnote proceeded in 2002. She stated that Mr. Graciano reviewed the City's CAFR and footnotes, and asked her whether the statement that the actuary was in the process of requesting GASB approval of the corridor method was still true. She told him that she did not know if it was true, and he directed her to ask Mr. Roeder. At that point, she emailed Mr. Roeder either the entire pension footnote or the relevant portion and asked him to review it, but never heard back from him. Later, she was discussing another matter with Mr. Roeder and asked him again about the footnote. He replied that he had not had time to review it, and Ms. San Pedro asked whether she could drop off the sentence regarding GASB approval. Mr. Roeder replied that she could remove that sentence.

Mr. Dahlberg asked whether she had an understanding of corridor funding at this time, and she replied that she did not. She knew that the City was paying less than the ARC, but knew this as "MP-1" not "corridor funding." Mr. Dahlberg asked whether, when reviewing the FY02 pension footnote, she considered MP-1 and corridor funding to be the same concept and she replied that she did. Mr. Dahlberg asked whether she understood that it was acceptable under GASB to pay less than the ARC and Ms. San Pedro stated that she thought it was acceptable because the difference was represented by the NPO, and GASB 27 dealt with this and related issues.

Mr. Dahlberg asked if she was aware that only certain payment mechanisms were accepted by GASB and that the corridor method was not one of the accepted methods. Ms. San Pedro did not know at the time the significance of the fact that the corridor funding method was not among the six funding methods approved by GASB. She did not recall whether anyone was trying to get the corridor method approved, and did not recall discussing this issue with Mr. Roeder or anyone at SDCERS. Ms. Miller asked if she had ever read that language in other footnotes and Ms. San Pedro responded that she had, but was not aware at that time to what corridor funding referred. She did not know who wrote that statement, and viewed her role in the preparation of this footnote as "filling in the blanks." Mr. Dahlberg then asked whether she asked Mr. Roeder or anyone else about other issues in the footnotes, and she replied that she had not made any other inquiries, and assumed that the outside auditors checked the information contained in the footnotes.

Mr. Dahlberg asked why she thought that Ms. Webster would not have reviewed the footnotes, and she replied that it was possible that Ms. Webster assumed that Mr. Graciano

would review them with the outside auditors. Ms. San Pedro did not know for certain whether Ms. Webster read the footnotes, but did not believe that she reviewed them with a “fine-toothed comb” like Mr. Graciano or the outside auditors would have. Ms. San Pedro suggested that this might have been because, while Ms. Webster was the most knowledgeable about pension issues, she did not know technical accounting rules. Ms. San Pedro speculated that Ms. Webster might have let Mr. Graciano’s section handle this review because the footnotes contained financial data. Mr. Dahlberg asked about the resolution of the inquiry to Mr. Roeder about requesting GASB approval for the corridor funding method and Ms. San Pedro replied that she believed the statement was dropped in 2002. Ms. San Pedro was not aware of other instances in which the corridor method was referred to as “excellent.”

Ms. San Pedro was shown an email from Mr. Roeder to Ms. Webster dated September 10, 2003, discussing his suggestions for changes to the City’s disclosure review procedures (Exhibit 8). Ms. Miller asked whether any of Mr. Roeder’s suggestions were ever implemented and Ms. San Pedro replied that she did not know, and that she had not personally changed her actions as a result of his suggestions. Ms. Miller asked whether the time she gave the pension footnote to Mr. Roeder to review was the only time she gave the footnote to anyone at or working for SDCERS to review, and Ms. San Pedro stated that this was correct.

***Pension Footnote: “NPO is funded in a reserve”***

Ms. San Pedro was shown an email from Mr. Roeder to Mr. Grissom and Mr. Barnett dated September 5, 2003, discussing Mr. Roeder’s realization that certain statements he made years ago were erroneously included in a recent debt issuance (Exhibit 9). Ms. San Pedro stated that she was not familiar with the debt issue referred to, or the concerns that Mr. Roeder expressed. Ms. Miller asked if this interview was the first time that she had read this email, and Ms. San Pedro replied that it was. Ms. Miller asked whether she remembered seeing the phrase “NPO is funded in a reserve” in the CAFR, and she replied that she knew the statement was in the CAFR and she did not think it was false because there was a reserve in a trust fund. She stated that the NPO was booked as a City liability and as a reserve in the retirement fund. Mr. Dahlberg asked how this was possible and Ms. San Pedro replied that she did not know, and that was why she had asked about this issue. Ms. San Pedro did not know of any changes that were made to the pension footnote as a result of the communications referenced in this email.

***Purchase of Service Credits and Deferred Retirement Option Program***

Mr. Dahlberg asked whether Ms. San Pedro was familiar with the concept of the Purchase of Service Credit (“PSC”) program, and she replied that she was. He asked if she understood that the money paid for these credits should have offset the liability the program created. She replied that she didn’t understand there to be a “liability” for this program at the time, and has only since realized that this system was operating at a loss. Mr. Dahlberg asked whether she thought that liabilities were building up for the Deferred Retirement Option Program (“DROP”), and she stated that she was not aware of this liability.

Ms. San Pedro said that she understood the distinction between accounting and actuarial liabilities, but stated that she never wondered if Mr. Roeder was calculating his liabilities correctly. Mr. Dahlberg asked if she understood that if Mr. Roeder incorrectly calculated his liabilities the NPO and UAAL could be incorrectly stated. She did not know this,

and did not understand actuarial valuations; she only knew where to look for the numbers that she needed, such as the funding ratio and UAAL, but did not know how Mr. Roeder calculated these numbers.

Mr. Dahlberg stated that someone at the City needs to be responsible for ensuring that liabilities are correctly booked, and asked who, as a remediation measure, should be responsible. Ms. San Pedro replied that either Mr. Graciano or herself should be responsible. Mr. Dahlberg followed up by asking whether someone who understands more about pension accounting than Mr. Graciano should be responsible, and Ms. San Pedro agreed. Noting that the actuary miscalculated the DROP payments and there was no oversight to catch this error, Mr. Dahlberg asked whether there should be more training for pension accounting. Ms. San Pedro responded yes, and did not know if the City currently provided such training or whether there was someone who currently works for the City who could challenge the actuary's conclusions. Ms. San Pedro stated that if she had known more at the time, she might have been able to catch this error.

Mr. Khona showed Ms. San Pedro a January 8, 2004 email from Ms. San Pedro to Ms. Webster regarding interest calculated for the DROP accounts (Exhibit 10). Mr. Khona asked Ms. San Pedro to explain the subject matter of this email. She replied that she remembered that Ms. Webster was concerned that the interest shown for DROP in the financial statements was low compared to the prior fiscal year. Ms. San Pedro remembered telling Ms. Webster that the numbers were consistent with those recorded in the general ledger, but after additional research she discovered that a quarter's worth of interest was missing from the general ledger. Ms. San Pedro also noted that Michelle Lawrence, who was referred to in the email, was an accountant in the Payroll department.

#### ***Post-Retirement Health Care***

Ms. San Pedro was shown an email from Ms. Chapin to Mr. Grissom and Ms. Webster dated March 30, 2000, regarding the 401(h) reserve (Exhibit 11). Ms. San Pedro was copied on an earlier email in the thread, which discussed the need to research whether the given method of transferring the City's 401(h) funds to SDCERS was legal. Mr. Dahlberg asked why this inquiry was needed, and Ms. San Pedro responded that there was a fund separate from SDCERS for health care that had a balance of \$6 million that was "just sitting there" and they were trying to determine how to get the money from that fund to the new reserve established for health care that was within the retirement fund. Mr. Dahlberg asked Ms. San Pedro to describe the work she did related to this discussion. Ms. San Pedro replied that she worked with Mr. Graciano on the debits and credits related to the general ledger system, and it was common knowledge that certain funds could not be used for certain benefits so they wanted to make sure that any transfer the City was going to make was legal.

Ms. San Pedro explained that no one knew why the old health care reserve still had a balance or what this money had been used for. Since transactions were occurring in the new health reserve, they had to research the issue and determine if it was legal to transfer funds from the old reserve to the new one. Ms. San Pedro was not an attorney, and assumed that Ms. Chapin would have looked into this issue. Mr. Dahlberg asked Ms. San Pedro if she knew about the taxability of health care benefits, and Ms. San Pedro replied that she had a vague understanding that this issue could affect the tax-exempt status of these benefits. She was aware

of the steps needed to remain compliant with the requirements for tax-exempt status, but was not involved in administering these actions.

Ms. San Pedro was shown an email from Ms. Webster to Mr. Wochaski dated September 9, 2003, regarding post-retirement health care funding (Exhibit 12). In this email, Ms. Webster referred to an answer that Ms. San Pedro gave regarding which entity was ultimately liable for post-retirement health care funding. Ms. Miller asked Ms. San Pedro if she could explain the issue referred to in the email, and she replied that did not remember this issue and did not think she received this email. Ms. Miller noted that the email reflects a discussion she was involved in regarding the funding of health care benefits. Ms. San Pedro replied that she did not recall this topic, and suggested that Mr. Wochaski might have asked her to explain how she calculated a certain number. Ms. Miller asked if she had any knowledge about the disclosure of the City's responsibility to pay for health-care benefits (if they could not be funded by SDCERS) in the City CAFR. Ms. San Pedro responded that she only remembered an issue about the health care fund being depleted.

Mr. Khona asked what she meant when she wrote that a number "still can be incorrect" even though it appears in the audited financial statements. She replied that a number can be incorrect even though it has been audited. Mr. Khona asked if there was a history of these types of occurrences, and she replied that she was not aware of other instances. He then asked how she could know that a number could still be incorrect even though it had been audited. She responded that she was not alluding to a prior experience when she wrote the email; she was only stating that the number recorded in the financial statements might be incorrect.

Mr. Khona asked if the incorrect interest number was changed, and Ms. San Pedro responded that the CAFR had already been printed at this time, but the correct interest was booked in the following year, and retroactively reflected the correction. Mr. Khona asked if this error was disclosed or just corrected and she replied that she thought it was just corrected, but she could not remember.

Mr. Khona asked what she meant in the email by her reference to "tweaking" the enterprise rates. She replied that the enterprise funds had paid their percentage of the NPO and she thought that they did not have any additional NPO liability and would begin to pay actuarially recommended rates beginning in FY04. Ms. San Pedro stated that when she was calculating the new employer contribution rates, she wanted to make sure that she did not burden the enterprise (or "business-type") funds with additional NPO liability. Ms. San Pedro then asked to clarify her answer. She stated that Mr. Roeder calculated the actuarially recommended rates for the whole City at once, but because there was a liability for the unpaid portion of the NPO by the governmental funds, she believed Mr. Roeder's rate was higher than it should have been for the business-type funds since they had fully paid their share of the NPO. She wanted to ensure that only the governmental funds were burdened with the additional costs of the unpaid NPO.

Mr. Dahlberg stated that he thought the City paid only one rate, and Ms. San Pedro responded that this was the reason she had to "tweak" the rate for the enterprise funds based on her knowledge. Mr. Khona asked if this "tweaking" was supported by GASB. Ms. San Pedro replied that Ms. Webster believed this was a fairness issue. Ms. Webster did not think it was fair to the business-type funds to be burdened since they had already paid their NPO contributions. Mr. Khona asked what the difference would have been if no "tweaking" had been

done, and Ms. San Pedro replied that it would have been negligible and that she told Ms. Webster that it was not worth the effort of modifying these numbers. Mr. Khona asked when these calculations were done, and Ms. San Pedro responded that they were only done at this point, not in prior years, since it was only this one year that the business-type funds fully paid their liabilities.

Mr. Khona then showed Ms. San Pedro an email from Ms. Webster dated February 3, 2000, titled "Re: Purchase of Benefit Plan" (Exhibit 13). Ms. San Pedro stated that she was not familiar with this email. Mr. Khona asked if she was aware of any issues regarding noncompliance with state or federal tax law, and she replied that she was not. Mr. Lee asked if this email came from Ms. San Pedro's computer, and Mr. Khona responded that it came from her hard drive.

Later in the interview, Mr. Khona showed Ms. San Pedro an email from Ms. Webster dated October 14, 2003, titled "Re: numbers," regarding the City's contribution shortfalls (Exhibit 14). Ms. San Pedro stated that she did not recall this email and that Ms. Webster handled this issue and she was only copied on the email. She noted that during this time there were phone conversations between Ms. Webster and Daniel Deaton (Orrick) that she was not involved in, so she did not always know what they were talking about. Mr. Khona asked if any aspect of this issue related to her, and she replied that she might have done some initial calculations on this matter. Mr. Khona asked her if Ms. Webster ever asked her about those calculations after they were completed. Ms. San Pedro responded that she did not recall and that Ms. Webster came to her for many calculations of this kind. Ms. San Pedro stated that she reviewed this document the morning of the interview (since it was used in her previous interviews) but that she did not understand it.

### ***Remediation***

Ms. Miller then asked Ms. San Pedro if there was any answer she gave during the interview that she wished to clarify, and Ms. San Pedro responded that there was not.

Ms. Miller then asked her what suggestions for remediation she would include if she were writing the Audit Committee's report. Ms. San Pedro stated that she believed that errors were made because there was not enough time available to spend on these issues. She noted that the CAFR preparation occurs pre-audit. She has her standard responsibilities, and then at the end of the year was further burdened with constructing the CAFR, and stated that it was difficult to handle both of these assignments. Ms. San Pedro suggested that she and others were not properly trained to understand some of these issues, and that it was difficult for her to find time for training. She stated that the City should review the wording of the footnotes with the outside auditors that provide certain numbers relating to those footnotes.

Mr. Dahlberg asked if she was pressured in any way during this period to reach certain results items with which she was tasked. She responded that she was not pressured, and in fact might have been "too independent." Ms. Miller asked if there was any improper behavior at the City that she thought the Audit Committee should look into. Ms. San Pedro stated that she was not aware of any improper behavior and that people were trying to do the right thing.

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